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July 27, 2001

Dear Xxxxx:

This letter is in response to your letter received by our office on June 19, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found on the Department's Internet website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

Please provide an answer in writing and cite the appropriate section of Illinois law to the following question.

What is the tax rate (6.25% use tax or 8.25% Schaumburg Sales Tax) for software purchased as follows: the purchase was from a vendor with an office in Schaumburg, Illinois. The maker of the software only sells through resellers. The maker of the software is in California. The California vendor shipped the software to the reseller (CITY address) who in turn shipped it to AAA. AAA responsible for Use tax (6.25%), or Sales tax in the amount of 8.25%?

Thank you for addressing this issue.

DEPARTMENT'S RESPONSE:

SOFTWARE

Generally, sales of "canned" computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of the enclosed copy of 86 Ill. Adm. Code 130.1935. Sales of software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable.

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See subsection (c)(3) of Section 130.1935.

If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software or the subsequent software

updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

SALES TAX & USE TAX

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See the enclosed copy of 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See the enclosed copy of 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases occur outside Illinois, purchasers must self assess their Use Tax liability and remit it directly to the Department. If the purchase occurs in Illinois and for some reason the retailer fails to pay Retailers' Occupation Tax to the Department and does not collect the purchaser's payment of Use Tax, the purchaser is required to remit the Use Tax payment directly to the Department.

LOCAL TAXES

For your general information, please see 86 Ill. Adm. Code 270.115 of the Home Rule Municipal Retailers' Occupation Tax for guidance concerning jurisdictional questions. In general, the imposition of the various sales tax related local taxes in Illinois are triggered when "selling" occurs in a jurisdiction imposing a tax. The Department's opinion is that the most important element of selling is the seller's acceptance of the purchase order.

Therefore, if a purchase order is accepted in a jurisdiction that imposes a local tax, that tax will be incurred by the retailer making the sale. The tax rate is fixed by the location of the seller, not the delivery location. The fact that the item being sold is shipped from out-of-State or from another Illinois location is immaterial for purposes of local taxes if the sale occurs through order acceptance in an Illinois jurisdiction imposing a local tax. For these transactions the local tax will be incurred by the retailer. Although 86 Ill. Adm. Code 270.115 deals with the municipal Home-Rule taxes, the principles outlined in this regulation apply to all local taxes administered by the Department.

If a purchase order is accepted outside the State, but the property being sold is located in an Illinois jurisdiction that has imposed a local tax, then the location of the property at the time of sale will determine where the seller is engaged in business for the purpose of determining the imposition of applicable local sales taxes. See for example subsection (b)(3) of Section 270.115.

Retailers in those locations are allowed to reimburse themselves for those locally imposed taxes. (See for example, 65 ILCS 5/8-11-1, which allows a retailer to reimburse himself for Home Rule Municipal Retailers' Occupation Tax [HRMROT] incurred under that Act.) That authority creates a corresponding legal duty of the purchasers to pay such reimbursing amounts to the retailers if those retailers use their statutory authority to collect such reimbursing amounts as a separately stated item (or in combination with the State Use Tax) from the selling price of the tangible personal property.

In your specific situation set out in your letter, if the software your company purchased is taxable as canned software as described above and the retailer failed to collect Use Tax on that sale, your company would owe Use Tax on that purchase in at the rate of 6.25%. Please note that the retailer remains responsible for the local tax the retailer incurred on that sale.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.